The Changing Landscape in Lending
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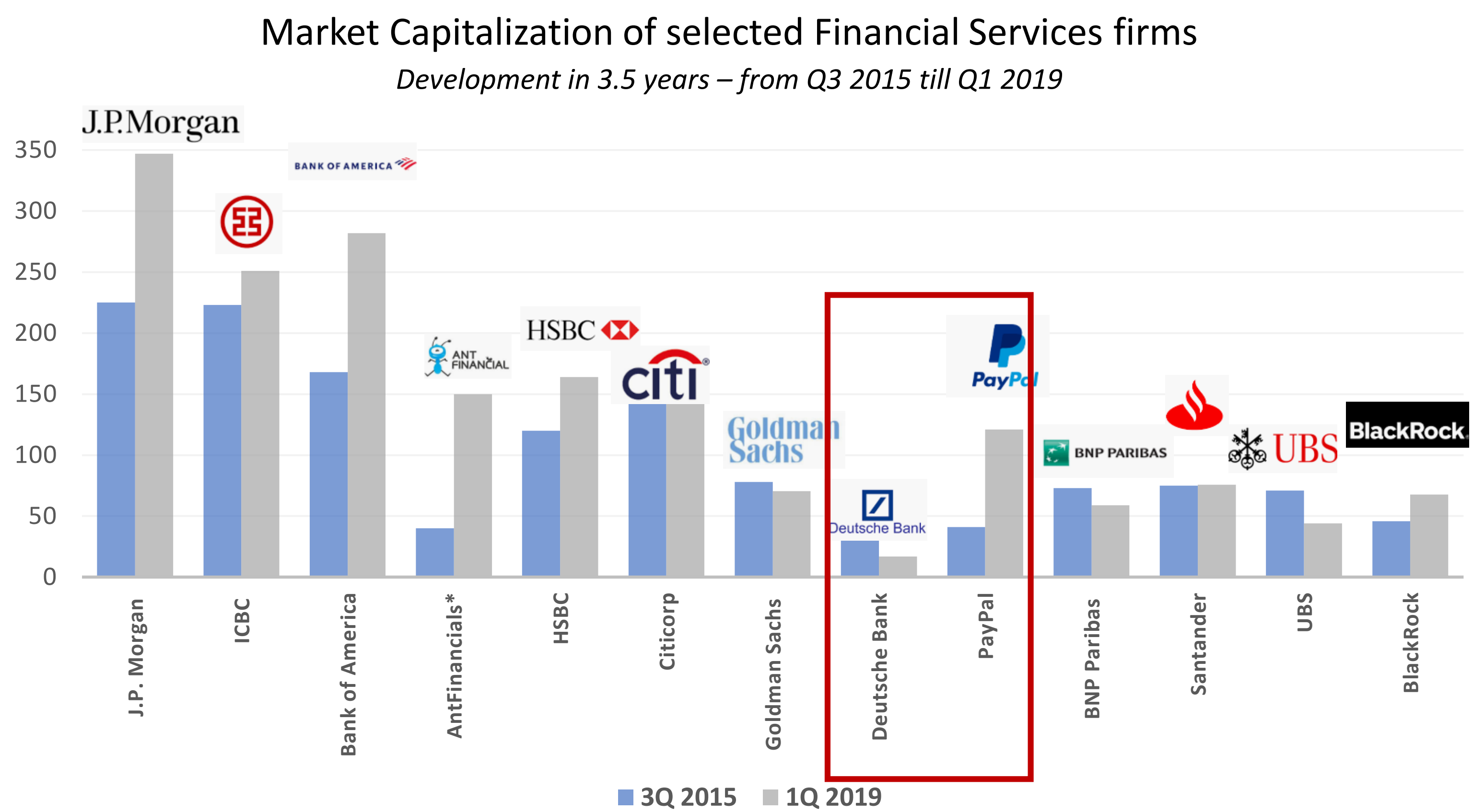
Massive Change and Redistribution of Wealth

At a level not seen before

1. **Around 28% of EUR area non-financial company debt issuance are held by euro area investment funds, up from 18% pre-crisis.** *(ECB, 1 May, 2019)*
2. **Capital raising in Fintech: USD 110 bn (1/3rd in Europe). 3000 companies, cc 800 SME Lending Platforms.** *KPMG, 2019).*
3. **BigTech Investments and Interest in Lending**
4. **35-40% of underwriting of SMEs happen via new digital origination models in Europe by 2025.** *(Citi, McKinsey)*

Fast changing space



**Private company. Estimates based on funding rounds. All figures are in USD billion.*
(Source: Gabriella Kindert, 2019.)

New names …..

Alipay™

amazon

PayPal

Klarna.

fidor BANK

MUNT HYPOTHEKEN

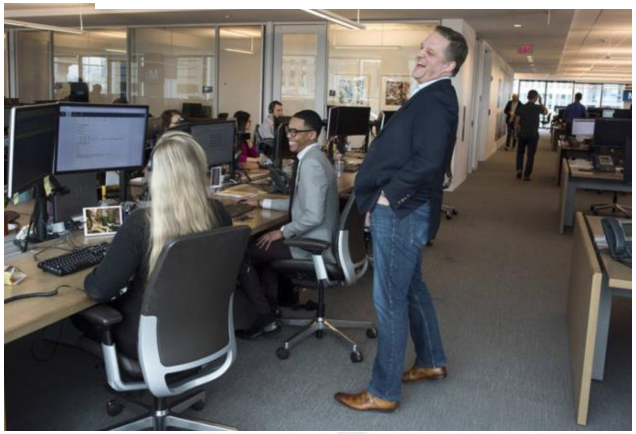
Marcus: BY GOLDMAN SACHS™

RAIZE

Style shift...

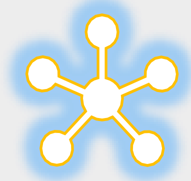
Marcus:
BY GOLDMAN SACHS ™

Goldman Sachs



The Drivers

Manifold factors coinciding

CONTRACTION OF BANK's BALANCE SHEET	DATA	CONSUMER HABITS	REGULATION PSD2 and OPEN BANKING
DEMAND FOR INVESTMENT PRODUCTS 	TECHNOLOGY 	E-COMMERCE 	BUSINESS MODEL INNOVATION 

The issue with the banking system in Europe

Moved from B/S issue to Profitability

- **Economic Value Added (EVA favours big, high grade companies)**
  - **Cost of Funding: Mismatch**
  - **Cost of Operation: Increasing compliance costs, FTE, Systems**
  - **Cost of Credit Loss: Cost of measuring, Systems**
- **Culture**
- **Inherited high costs structure with old IT systems**

Big Data Insight – New Ecosystem is born

Often outside the financial system

Data Source

Moving to Big Data and New Digital Sources

Conventional data points

Financial Statements; Income tax returns, Latest cash flow statements
Credit Bureaus

New Data Points

Email verifications
Location; Education, Job history
Social Network
Ecommerce transaction data
Behavioural relates (to complete, spelling mistakes)

Data Analytics

(Quantity and Methods)

Data Points: AI (12k – 100k)
Machine Learning

AntFinancials
Lenddo
ZEST
underwrite.ai
TALA - Ginimachine
James Credit Scoring
Elevate
SAS Enterprise Miller
Petal - Affirm
ING – NIBC - BBVA – GS
Funding Circle

Credit Scoring

Higher accuracy, Loss Reduction

Faster disbursement Detection of fraud - KYC
Anti Money Laundering - Terror Financing checks

Disbursement

Robotic Process Automation

Faster disbursement Detection of fraud - KYC
Anti Money Laundering - Terror Financing checks

Monitoring

Early signals and Predictive Features

Detection of fraud
Automated risk pricing

New approach to Business Models

Funding and Liquidity	Reporting	Data Management
Standardization ALM Matching Involving Retail Funding ***CrossLend, Brismo, Bedford Row Capital***	Deal Sourcing Reporting MIS ***Efront, BlackMountain, CEPRES Dealnexus, Axial***	Shared Database Blockchain Technology ***Corda (R3)***

Caveat:

- **Standardisation remains a challenge**
- **New Risks are born**

What is the Problem we are trying to solve? Who benefits?

Benefits: Above all for consumers

Similar to other industries (Telecom, Music)

Better Pricing	Better analysis - Better ability to predict default (25-50%) "Machine learning may reduce credit losses by up to 10 per cent" (McKinsey)
Cheaper Faster Underwriting	Significant reduction 25-90%
Personalization & Fair	Better services Bias reduction
Inclusion	46 million Americans "credit invisible,": no file at one of the three major credit bureaus

Key take aways

Fast forward 5 years from now

1. **Many element of the underwriting risk assessment and servicing process will be a more digital AI based process**
2. **Some applications and standards used in lower SME segments are likely to move up**
3. **Higher standardisation in risk assessment and reporting and widely applied MIS application to help efficiency**
4. **More Private Debt firms partner up to create a shared transaction database**

Discussion

Value Proposition and Risks

	Corporate and SME Debt – different markets / different approach			
	Leveraged Loans	Direct Lending Private Equity backed	Direct Lending Corporate - SME Sponsorless	**Direct Lending SME (Digital)**
	BESPOKE WITH INCREASING ELEMENTS OF STANDARDIZATION	BESPOKE ASSET SELECTION	BESPOKE ASSET SELECTION	**PORTFOLIO APPROACH**
Typical Borrower Size EBITDA	EUR 250 mln +	**Wide Range** EUR 20 – 250+ mln	**Wide range** EUR 5 – 150 mln	EUR 10 k – 1 mln
Transaction Management & Costs	Strong External Due Diligence package Standardized LMA High Fee	Strong External Due Diligence Bespoke Often Unitranche High Fee	Due Diligence but often limited scope High relative transaction cost	No independent DD Financial Statement Business Plan **Digital Risk Assessment**
Origination Channel	Bespoke Capital Market M&A advisory PE relationship	Bespoke Strong network with PE network and relationship required	Bespoke M&A advisory also digitial channels	**Digital Matching** Standardization Reduced Cost
Liquidity	Secondary Market	Limited	Limited	**Increasing Digital Secondary Market Solutions**

Key risks within disintermediated lending

Discussion Points

Alignment of interests

- One of the reasons behind the recent financial crisis: detachment of the credit risk from the originator (no “skin in the game”).
- This is mirrored in the fragmented nature of FinTech within the value chain.

Overconfidence bias & illusion of control

- Technological innovations do not always lead to superior risk assessment capabilities.
- Overconfidence can lead to a false belief that new technologies greatly improve our predictive abilities.

Differences in regulation blur the picture

- In the presence of exceptionally high regulatory burden for incumbents, new players enjoy significant competitive advantage.
- Could FinTechs sustain their business model and competitive advantage if faced with similar regulations?